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September 19, 2005

AGENDA ITEM 8a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Update on Investments in Companies Doing Business in Sudan
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information Only
- IV. ANALYSIS:**

Executive Summary

In light of the tragic events in Sudan, CalPERS staff has undertaken a broad effort over the course of the last ten months to engage relevant parties with regard to any investments in companies operating in Sudan and includes:

- Building a coalition with four other public pension plans to establish an engagement process with companies doing business in Sudan.
- Identifying, through its coalition with four other public pension plans, five companies to directly engage concerning business activities in the Sudan. These companies and a report of our engagement to date with them are included in this agenda item.
- Building a second coalition of 50 pension funds that engaged the U.S. Department of Commerce, U.S. Department of State, U.S. Department of the Treasury, and the U.S. Securities and Exchange Commission.
- Engaging 46 external investment managers and 1,869 portfolio companies in an effort to identify companies that may be operating in Sudan.
- Outlining a five step process on page six of this agenda item in response to concerns that our companies are operating in Sudan.

To date, CalPERS has not identified any company in its portfolio that condones, supports, or furthers the atrocities in the Sudan.

Introduction

Over the last several years, ethnic and racial tension in the Sudan has escalated to the level the United Nations and the U.S. Department of State characterize as “genocide.” This tragedy is born out of centuries of exploitation of black Sudanese in the Darfur region in a slave trade carried out by nomadic Arab horsemen commonly referred to as the Janjaweed.¹ In recent years the Sudanese government and Janjaweed militias have been targeting black Africans in a horrific series of mass murders in the Darfur region of Sudan. In recent months, it has been suggested that companies that do business in Sudan may thereby be furthering or condoning the nation’s support for terrorism or the egregious human rights violations occurring in that country.

A company associated with the atrocities taking place in Sudan poses a serious risk to creating sustainable and responsible long-term value. Any such company runs myriad risks including but not limited to federal and international sanctions, substantial fines and penalties imposed by authorities, an impairment of their ability to raise capital in public markets as well as long term reputational damage. The actions Staff have taken thus far, and the process outlined in this item, are designed to ensure CalPERS monitors and manages any such risk. In addition, CalPERS wants to assure its participants and the marketplace as a whole that it is not unwittingly investing in companies that support terrorist activities or activities that violate human rights.

Request by Treasurer Angelides and Willie Brown, Jr.

By letter dated August 8, 2005 (Attachment 1), CalPERS Board Members Treasurer Angelides and Willie Brown, Jr., requested that CalPERS ensure that the pension fund’s investments in companies doing business in the Sudan are not contributing to genocide and human suffering in the Darfur region of that country. Specifically the Treasurer and member Brown’s letter requests that staff provide to the Board a report identifying any companies that have business operations in the Sudan and the exact nature of those business activities. Secondly, they requested that CalPERS take all necessary steps to ensure that companies are not engaged in any business activities that in any way support genocide in Darfur including directly engaging with each company with the goal that they cease all such activities. In addition at the May 16, 2005 meeting, State Controller Steve Westly requested that staff develop a strategy to draw attention

¹ Ruffin, David. “Darfur: Genocide in Plain View.” *The Crisis*. January 2005.

to issues (such as ethnic cleansing in the Sudan) of global concern. At the August 15 Investment Committee meeting, the Chair directed staff to report back at the September meeting on its activities to date.

CalPERS Actions to Date

Over the last ten months, staff has developed and implemented a plan to identify companies in which CalPERS invests that are doing business in the Sudan and to constructively engage select companies. This plan remains consistent with the fiduciary duty we owe our members and beneficiaries.

Given the complexity of the issue, as well as the nationwide attention it has received, staff has worked closely with its federal legislative representative on this matter, and has engaged with various other entities in moving forward. Staff formed a coalition with four other public pension plans to establish an engagement process with companies doing business in Sudan. This coalition includes the Illinois State Board of Investments, the California State Teachers' Retirement System, the New York State Comptroller, and the Treasurer of the State of Connecticut. In addition, Staff has worked with industry groups such as the National Association of State Retirement Administrators (NASRA). Finally, we note that given the strong interest expressed by California Congresswoman Barbara Lee on this subject, staff has, through our federal representative, kept her office informed of our activities.

Over the past months, staff has kept the Investment Committee informed, through several briefings of its progress on this issue

Identification of Pertinent Companies

In an effort to identify companies operating in Sudan that may be engaged in non-humanitarian activities staff has:

- Consulted four Federal Authorities (U.S. Department of Commerce, U.S. Department of State, U.S. Department of the Treasury, and the U.S. Securities and Exchange Commission) with a coalition of 49 other pension funds.
- Contacted 1,869 portfolio companies.
- Worked with 46 external money managers.
- Formed another coalition with four other public pension funds to constructively engage companies where there was a specific concern that these companies may be inadvertently supporting the atrocities in Sudan.

Identifying specific companies that may pose risk to the portfolio based on their activities in the Sudan is a challenging task. While domestic companies doing business in the Sudan without prior federal authorization may be sanctioned and

listed on the website of the Office of Foreign Asset Control (“OFAC”), there is no central location listing non-U.S. companies operating in the Sudan. A number of websites such as SudanDivestment.com, SudanDivestment.org, and Divestterror.org, list companies doing business in the Sudan; however, no two lists are alike. In some instances, the public company itself may not actually do business in the Sudan while its parent or holding company does, or the company may be in the process of divesting its assets in the Sudan.

Of the 1,869 domestic portfolio companies contacted by CalPERS, 204 companies replied with the great majority stating that their firms had no business dealings with the Sudan or its government. Eleven companies disclosed past or present business activity within the Sudan, with most of them indicating that their activities had been carried out within the regulations and requirements of OFAC, a division of the United States Treasury Department. None of CalPERS’ 46 external managers identified companies having business dealings with the Khartoum government.

Engagement with Federal Authorities

In extensive discussions with other public pension fund representatives and associations, CalPERS staff concluded that the United States government is the only appropriate entity to identify a comprehensive list of companies that do business in Sudan. The United States government is the one credible centralized source with the capability of understanding national security and human rights implications of company operations and of directing appropriate prohibitions and sanctions against these companies. This is a similar approach to the one the Investment Committee adopted after September 11, 2001 when the issue of identifying companies supporting terrorist activities came to the forefront.

Therefore, CalPERS formed a second coalition with 49 other public pension funds, and in June 2005 wrote to the U.S. Department of State, the U.S. Department of Commerce, the U.S. Department of the Treasury, and the U.S. Securities and Exchange Commission, requesting that they identify, monitor, and report companies that – by virtue of doing business in Sudan – may be acting contrary to US foreign policy and humanitarian objectives. On June 6, 2005, a number of national organizations² wrote supporting letters to each of the federal entities to express support for our position.

² The national organizations include: National Association of State Auditors, Comptrollers and Treasurers (NASACT); National Association of State Retirement Administrators (NASRA), National Conference on Public Employee Retirement Systems (NCPERS); National Conference of State Legislatures (NCSL); and National Council on Teacher Retirement (NCTR).

To date, we have received responses from the U.S. Department of State and the United States Department of Commerce (Attachment 2). Both responses referred us to the Departments' websites where they maintain various lists of individuals and companies that have either violated U.S. laws or require additional due diligence prior to engaging in business. The Department of Commerce stated that it will discuss the possible integration of its lists with the lists maintained by the Department of the Treasury and State; however, it also noted its concerns regarding the creation of a single comprehensive database of entities with business or financial ties to terrorist-supporting nations. Since certain business or financial activities are not prohibited by law, it is concerned that identifying firms engaged in business or financial activities not prohibited by U.S. law could be misleading and damaging to those firms.

Our efforts with federal agencies are ongoing. Among the multiple tactics to pursue in addressing the atrocities in the Sudan, one is to engage federal agencies to approach and engage companies whose activities are in question.

Constructive Engagement

Simultaneously with contacting the federal government to enlist its support, Staff undertook an effort to identify and engage a select number of international companies in which CalPERS invests and that are reported to do business in the Sudan. In doing so, staff has worked closely with its first pension fund coalition to take advantage of our collective voice as shareowners.

In an effort to move forward with productive engagement of companies doing business in the Sudan, the pension fund coalition identified five companies doing business in the Sudan. These companies have been cited by multiple sources including their own websites as doing business in Sudan.

Among the many sources used by the pension fund coalition in identifying these five companies were activist literature and websites as well as other available sources. It should be noted that domestic companies legitimately doing business in the Sudan and international companies engaged in humanitarian and constructive activities in the Sudan are not considered candidates for engagement. Rather companies engaged in any transfer of revenue to the Sudan government or specifically tied to the extraction of oil in Sudan are the companies under the utmost scrutiny and therefore prime targets for CalPERS and coalition engagement.

By letter dated June 30, 2005, and in conjunction with the first pension fund coalition, CalPERS contacted five companies. A matrix of these companies and their activities as well as CalPERS holdings is included in Attachment 3. In this letter (Attachment 4), we requested full disclosure of direct or indirect business

activities in Sudan. To date, we have received responses (Attachment 5) from all the companies except Alcatel. The companies that have responded indicate that they are sensitive to the humanitarian issues in Sudan. The coalition is in the process of engaging these companies to obtain further information. The coalition currently has a meeting set up with ABB Ltd. Staff is coordinating a strategy and coalition engagement for Alcatel which has not responded to our original letter.

We note that this constructive engagement is consistent with Assembly Concurrent Resolution 11 (ACR 11) (Dymally), which has recently been adopted by the Legislature (Resolution Chapter 98, Statutes of 2005). The resolution encourages CalPERS and CalSTRS, within their fiduciary responsibilities, to encourage companies in which the funds invest to act responsibly and not take actions that promote or otherwise enable human rights violations in Sudan. The CalPERS Board took a support position on ACR 11 on May 17, 2005, prior to its adoption by the Legislature.

Next Steps

Staff will continue taking appropriate steps to ensure that companies in which CalPERS has ownership positions are not engaged in any business activities that support genocide and human suffering in Sudan. Specifically, staff is committed to the following next steps:

1. Continue efforts at the federal level, such as OFAC, to identify companies in which the System has holdings and that have business operations in Sudan in order to make prudent investment decisions.
2. Submit letters of inquiry to companies against which OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan. Our letter of inquiry will focus on what measures, if any, a penalized company has taken to prevent business activities from being performed in Sudan other than what is permitted under the OFAC sanctions program.
3. Work jointly with a coalition of institutional investors in an effort to appropriately identify, engage, and consider all investment options in companies that condone or support terrorism or the egregious human rights violations currently in Sudan.
4. Engage companies directly associated with doing business in Sudan to ensure that those companies in which CalPERS is an investor are not engaged in business activities that support genocide in Sudan.
5. Reporting to the Investment Committee on companies identified by staff as contributing in any way to the perpetuation of genocide and human suffering in the Sudan.

V. STRATEGIC PLAN:

This item is not a product of either the 2005-2006 Strategic or Annual Plans.

VI. RESULTS/COSTS:

Costs associated with this item include significant staff resources to research, identify, and engage companies labeled as doing business in Sudan.

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